Office of the Assistant Secretary of the Navy
(Financial Management and Comptroller)

Department of the Navy

Financial Improvement Plan (DON FIP)

The Road to a Clean Opinion

A New Paradigm for the DON

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Agenda

* Background/Context
* DON Financial Management Lifecycle
* Preparing for a Financial Statement Audit
* Strategic Approach/Timeline
* Opportunities and Challenges
* The Purpose of Today and Tomorrow

* Consider that:
  - In the Private Sector, achieving a “clean” opinion is considered normal business – but they have had problems recently (e.g. Enron)
  - If DON were a Fortune 500 Company, we would be #5, just above General Electric
  - DoD is the only Cabinet-level Department to **NOT** have an acceptable audit opinion
  - We apply greater rigor and discipline to our operational mission business (e.g. Nuclear power, Flight safety, etc.) than to our financial management business
    - Why?

How Do We Know if We Have Discipline in Our Processes?

Operational Reviews

(Usually Yes)

* INSURV
* PEB
* Flight Safety
* Nuclear Reactor Program

Administration

(It Depends)

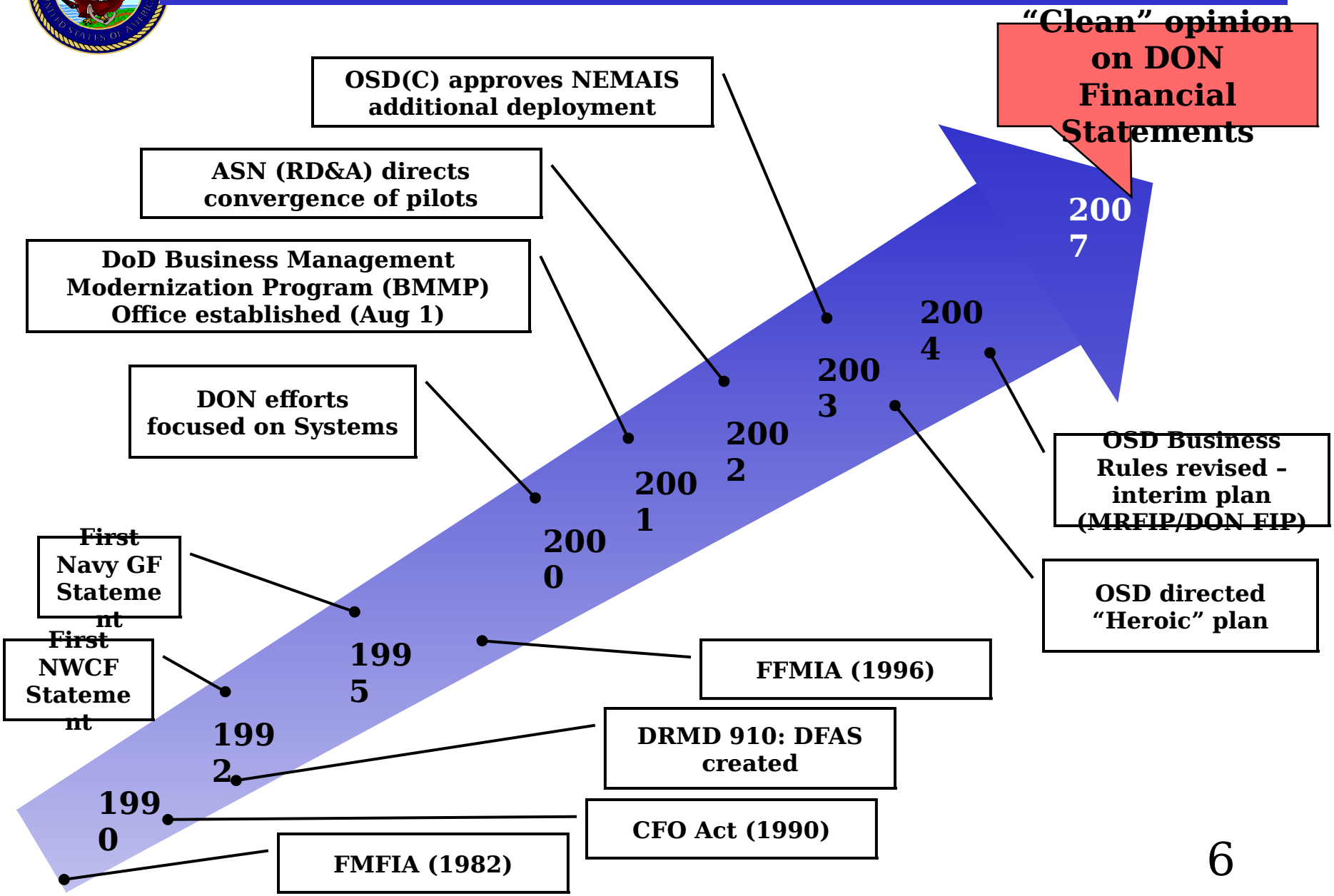
* Program Audits
* Management Control Program
* Admin / IGs
* Financial Statement Audits

14 years, and no audit opinion later, a new environment has emerged…

* DoD Relationship to Fed Govt Opinion
* DoD ‘Business Rules’/ Process Finally Established
* DON has Resources on the Table
* FMB Engaged
* Increased Understanding

We’ve already come a long way !!

The Path to Auditable Financial Statements

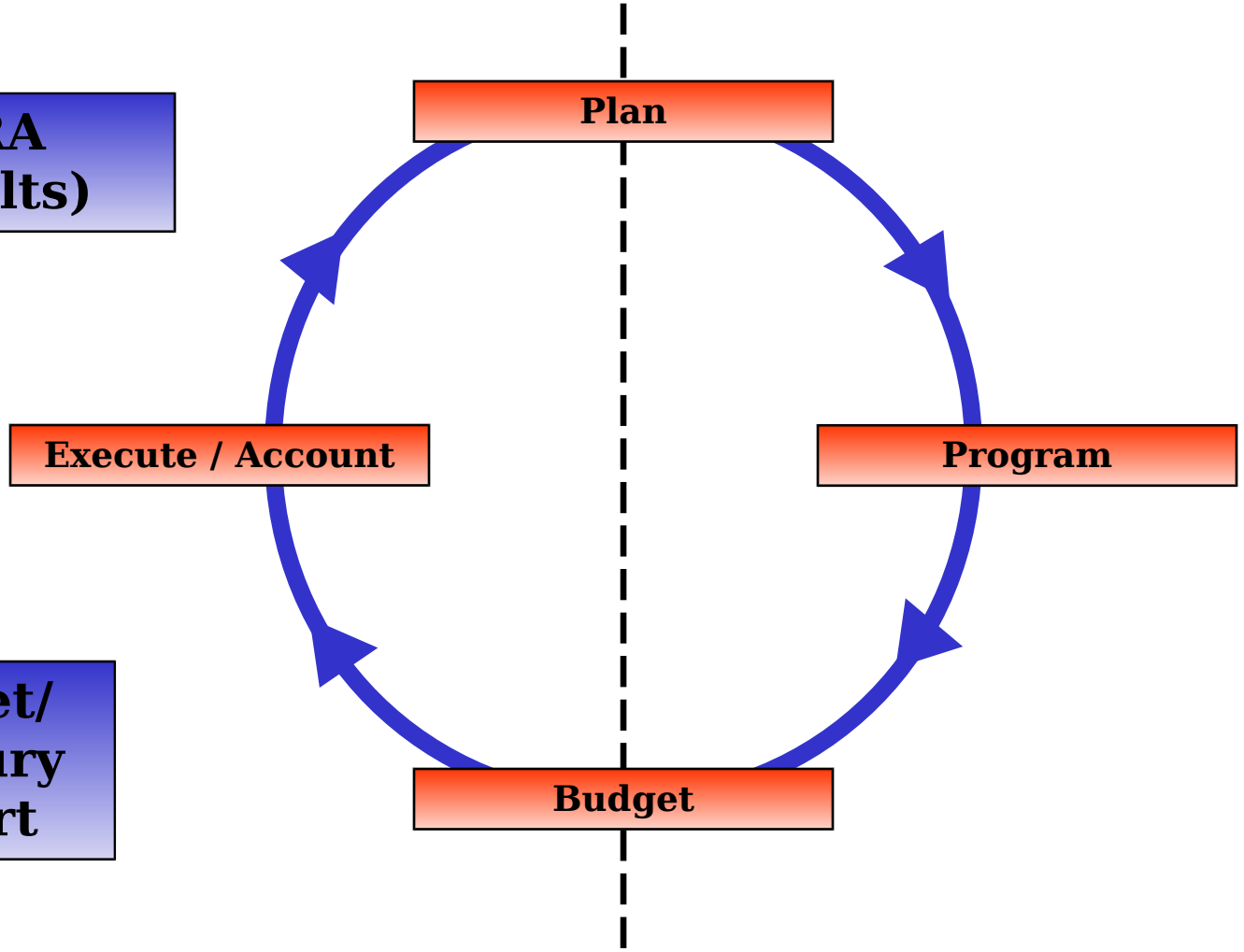


The Lifecycle: DON Financial Management

GPRA (Results)

A F S

Budget/ Treasury Report



We need to add demonstrated accounting proficiency to traditional DON Budget/Program strengths.

Key Components:

* Business Rules and Documentation
* Sound Systems Environment
* Ready Access to Audit Trails and Audit Evidence
* Management Control Program
* A New Paradigm Shift – Not Just for Auditors but also for Management

Business Rules and Documentation

DON

Discovery and Correction

- Develop improvement plans
- Implement corrective actions
- Establish audit committee
- Develop systems strategy
- Prepare business cases for systems changes
- Prepare and review full set of financial statements each quarter

Validation

- Management requests validation of financial information ('horizontal' and 'vertical' approach)
- Obtain comment from IG and notify Review and Prioritization Subcommittee (RPS)
- Commands document and maintain processes that support validation

Assertion

- Complete assertion package and return to IG
- Agreement with Engagement letter and management representative letter
- RPS and Funding Subcommittee review, prioritization recommendation to ESC
- ESC approval for assessment/audit required before IG contract funds obligated.

OSD/DoDIG

Assessment

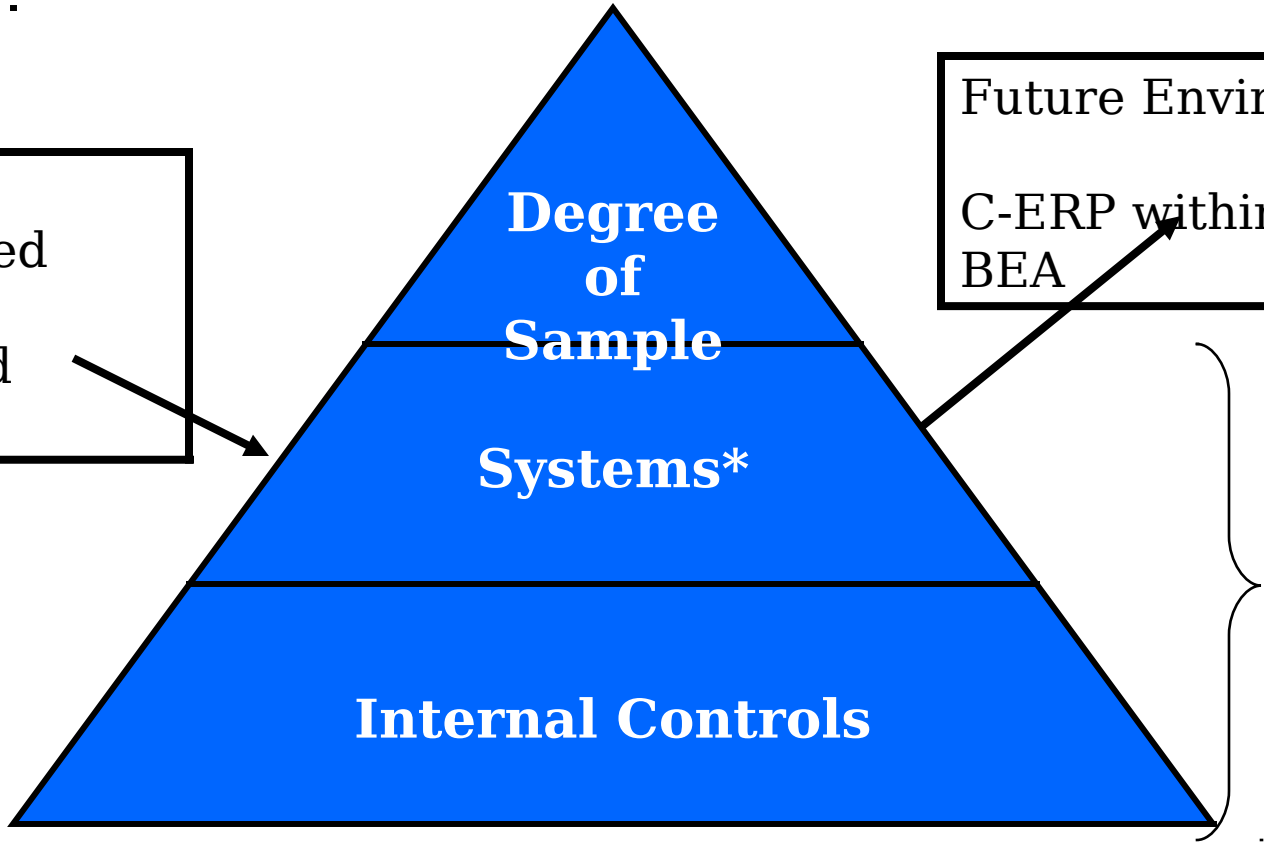
- OIG/Oversight
- DoDIG in-house or oversight of IPAs.
- If pass, schedule the audit through ESC approval process

Audit

- DoDIG performs the audit of DON financial statements

Auditor Order of Attack

- Security
- Embedded Controls
- Standard Processes



Future Environment:

C-ERP within DoD BEA

Level of Assurance?

***Systems are critical**

Ready Access to Audit Trails and Audit Evidence

* Auditors have a time window in which to complete an audit, e.g. SSC San Diego
  - Audits are rigorous by design; management being properly prepared facilitates the audit
* Audit trails and audit evidence must be readily available and produced
  - Easy and timely access to source documents facilitates the audit
* An auditor needs an understanding of your business, to assess how to best conduct the audit
  - A well documented business facilitates the audit

Management Control Program

* Risks are inherent in every process or system
* Assessing internal controls are a major component of the audit
  - An inadequate control environment can lead to an unfavorable audit opinion
* A sound Management Control Program establishes the framework and confidence that risks are continually reviewed, evaluated, and mitigated

ivate sector has been directed to follow publ
sector model (FMFIA) → Sarbanes/Oxley Act

DON Old Paradigm

No Financial Focus

* Command management's primary focus on business/org mission accomplishment; Accountability for Financial Position delegated to Comptroller.

Business Functions

* Budget execution/obligation focus
* Manual processes and limited ability to track results
* Limited documentation

Audit Community

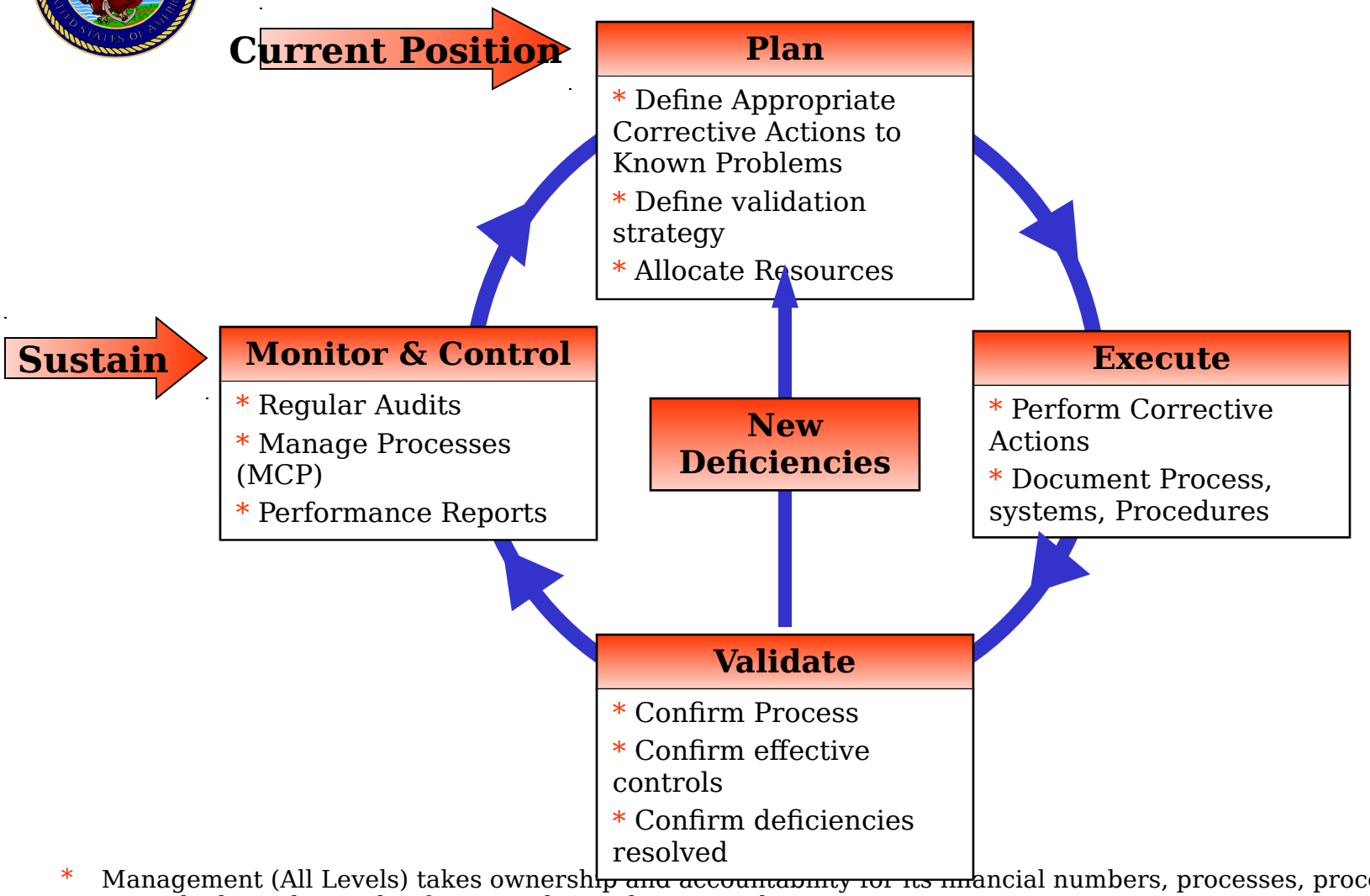
* "Shock and awe"
* Auditors have to dig to find information
* Adversarial relationship with Commands

Reactive Issue Response

* Review audit report findings
* Perform Corrective Actions based on audits

Management Controls not well documented and communicated to all levels to ensure financial management business processes result in accurate, supportable numbers

DON Paradigm Shift, New Business Model



* Management (All Levels) takes ownership and accountability for its financial numbers, processes, procedures, and controls through a cycle of continual reevaluation and improvement.
* Corporate leadership and auditors share common goal of earning “clean” audit opinion.
* Financial Management- “Not just for Comptrollers anymore”

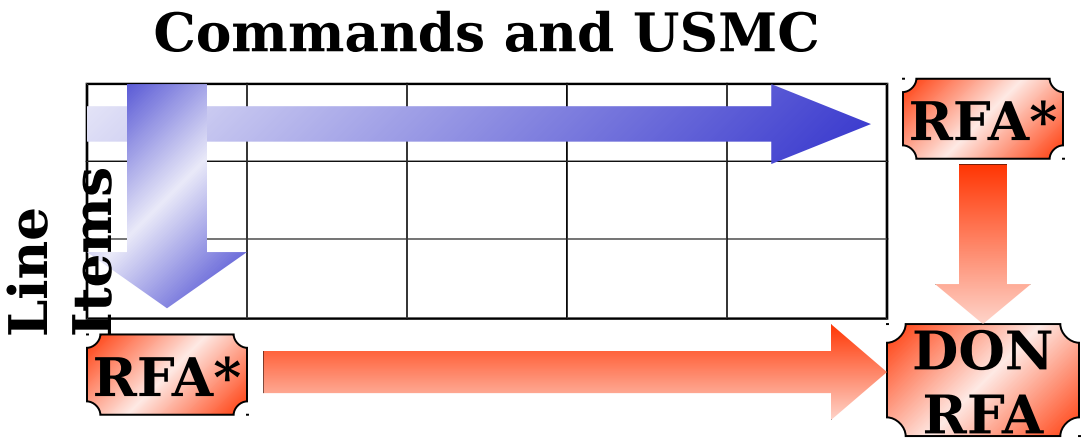
Assertion Process

* OSD Assertion Requirement
  - DON must prepare a formal assertion package for each financial statement line item
  - Assertion package must follow the format prescribed by OSD (OSD Checklist)
  - ASN (FM&C) must sign-off on each assertion package
* DON Approach to Formal Assertion
  - Initiate effort to correct material deficiencies
  - Utilize a structured methodology [based on GAO/PCIE Audit Manual and OSD Checklist] to document financial processes and systems, assess internal controls, and substantiate reported balances (FMO)
  - Decentralize the documentation, data collection, and initial assessment to the Major Command level (Commands, Marine Corps, DFAS)
  - Compile and assess packages (FMO)
  - Validate material deficiencies are resolved and internal controls are sufficient (Naval Audit Service, FMO)

N first to process a Validation Packag

DON FIP Strategic Approach

* Dual Track and Modular
  - Vertical Approach
    - USMC (Selected entity)
    - NWCF (Activity level)
    - Navy GF (Developing tools for Major Claimants)
    - Uses “Chain of Command”
  - Horizontal Approach
    - Selected Lines
      - FBWT
      - Other Liabilities
      - Military Equipment
      - Environmental Liabilities
      - Other
    - A “program within a program”

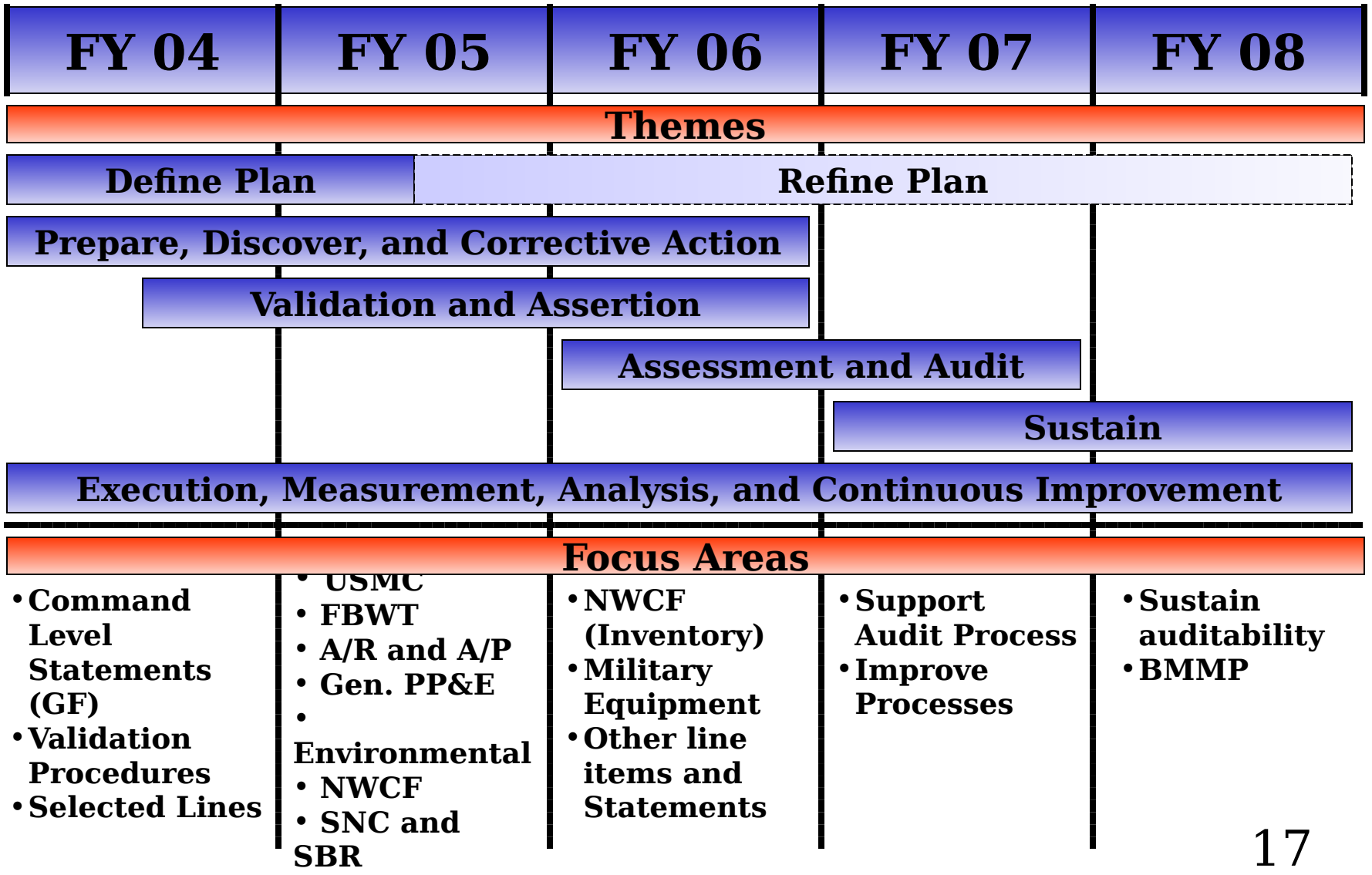


**** The obtainment of the DON “clean” opinion can be viewed as the summation of its “clean” parts.***

Need to know “what’s happening” so there is no duplication of effort

*** RFA = Ready for Audit**

Strategic Timeline



Opportunities and Challenges

* Opportunities
  - Assume leadership role for DoD
  - Enhanced Public credibility
  - Demonstrate compatibility between mission and financial stewardship
  - Accurate/auditable financial information will improve efficiency and decision making
* Challenges
  - Securing buy-in and commitment from Comptroller and Non-Comptroller Community, Navy, and non-Navy organizations, etc.
  - Securing Executive Sponsorship for the effort (Not just FM community)
  - Effectively prioritizing scarce resources
  - Meeting reporting demands of OUSD(C)
  - Structured preparations for audits will represent a new unfunded workload for Commands

A Tremendous Communication/Change Management Challenge

Key Strategy Elements

* Manage Expectations
  - Message:
    - Huge undertaking
    - Will compete with other DON priorities
    - Build incremental success on smaller victories
* Clear/Consistent Communications
  - Message:
    - Important for Public confidence / DON credibility
    - Can accomplish mission and also properly account for resources financially
    - Will require a change in mindset
* Measured Progress/Demonstrated Return on Marginal Investment
  - Message:
    - Process changes must produce results and be sustainable

* Day 1:
  - The Big Picture and What's Changed

* Day 2:
  - The Mechanics and Tools
  - Where Do We Go From Here?

eed to work together to lead this pr